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TESTIMONY BY
DONALD N. LEDBETTER, PRESIDENT
NATIONAL ASSOCIATION OF POSTAL SUPERVISORS

BEFORE THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
U.S. SENATE
WASHINGTON, DC

SEPTEMBER 9, 1985

Representing supervisors in the United States Postal Service

Mr. Chairman, Members of the Committee: My name is Donald Ledbetter and I am President of the National Association of Postal Supervisors, an organization representing some 44,000 mid-level managers in the U.S. Postal Service. With me is Andrew E. Ruddock, a retirement consultant to our organization. We are pleased to be here today to offer our views on S. 1527, a bill to establish a new retirement system for postal and federal employees hired after December 31, 1983.

At the present time, we have very few members who would be immediately affected by S. 1527. The majority of supervisors are promoted from within the carrier and clerk craft unions in the Postal Service and not newly hired from outside industry. We are, however, deeply concerned about the new supplemental retirement program and not simply from the standpoint of future members. This retirement legislation will be the most important piece of pension legislation since the passage of the Employee Retirement Income Security Act in 1974 and will eventually create the largest retirement program in the country. We believe the federal government should be a leader in the development of sound personnel policies, particularly now since people are making career decisions based on more than just salary.

Mr. Chairman, we would like to congratulate you and particularly Senator Stevens for your diligence, hard work and leadership in this area. I personally can remember no other issue, with the possible exception of the Postal Reorganization Act, over which so much time, effort, discussion and debate have been expended. We began this process nearly four years ago with Senator Stevens and appreciate the cooperation extended to us throughout that time by Senator Stevens and his staff. You, Senator Stevens and Senator Eagleton did an excellent job in insuring that all interested parties had the opportunity to express their views. The public policy forums in particular held in late 1983 and 1984 gave a good, solid background on which to begin this debate.

We agree, Mr. Chairman, the time to move ahead on the development of a supplemental plan is now. Because of the wealth of information that is available, we think it is possible to develop a plan this year that meets the needs of employees, the employer and, in our case, the taxpayer as well. We have come a long way since those first meetings. Many of the concerns we expressed several years ago have been overcome by provisions of S. 1527.

In my testimony today, I would like to review some of the provisions of S. 1527 we support, some we do not and some specific recommendations for changes. Despite our continued opposition to Social Security coverage for any postal or federal employee, we recognize the reality of the situation and for that reason do support the three-tiered approach contained in your legislation. The combining of social security with a defined benefit supplement and a thrift plan is the best possible combination of prevailing practices in both the public and the private sectors.

We strongly support the use of the present Civil Service Retirement Fund for the financing of both the old and new systems. As you will recall, one of our major concerns in the Social Security debate was the drain on the Civil Service Retirement Fund if new entrants were totally cut off. That is not the case in S. 1527.

In general, we are also supportive of the disability provisions. The inclusion of Social Security disability benefits provides a higher replacement of predisability earnings if the employee meets the Social Security definition of disability. If the employee is regarded as disabled only for his or her job in government, the disability benefits remains about the same as now provided by the current system. We do not, however, see the advantage in having a third party administer the disability program outside government. The framework for the payment and

distribution of disability benefits is already in place. Obviously the required coordination with Social Security would add to present administrative costs, but we think handling claims in-house would be less costly than contracting out that function and thereby paying profits to a private insurance company.

As I mentioned, we do have problems with some of the present provisions of S. 1527. First and foremost, we are concerned with the overall level of benefits. From our perspective, there is no reason to adopt a plan that costs 17% less, as a percentage of payroll, than the present Civil Service Retirement system. Social Security coverage has necessitated two different retirement programs, but in our opinion, the problems need not be exacerbated by making those differences so wide as to create sharp distinctions in what one employee receives over another.

An employee under the new system would naturally resent the prospect of receiving less retirement benefits than an older employee working side by side doing the same job. This would create unnecessary and harmful morale problems. In light of the findings by Hay Associates, as reported to the House Post Office and Civil Service Committee, there is no justification for the federal government to provide such a low-cost plan. As Hay noted, total federal pay and benefits are already 7.2% less than those in private industry. Hay further found the present employer cost of Civil Service Retirement benefits is less than the payroll cost of 25.1 percent or more for the top 10 percent of large employers in private industry.

The average retirement cost for the private sector we hear most often is 18.5% of payroll. However, that percentage takes in the mediocre and those private companies that have little or no retirement benefits for their employees. This brings us back to the basic argument on the role of the federal government. We believe the federal government should be a leader because of its size and the nature and importance of its work. The functions of

government, in one way or another, impact on every person in this country every day. The federal government cannot nor should not be compared to a small computer company for instance. That company may do important work, but its role is not anywhere as varied nor as widespread as the role of government. In order for the federal government to effectively compete for quality employees, the government must provide a benefits package similar to that offered by the top companies in private industry not the average or mediocre.

Secondly, although we support the concept of a thrift plan, we do not think government's contribution should match 100% up to the first 5% of employee contributions. We object to the matching provision for several reasons. First, the prevailing practice in the private sector is to match 50% up to 6% of employee contributions. The costs for the higher government contribution in S. 1527 could be better used to improve the defined benefit portion of the plan. We recognize that one purpose of the thrift plan is to partially offset the tilt in Social Security since higher paid employees would undoubtedly participate to a greater extent than lower paid employees. However, we do not think higher paid and older employees should receive disproportionately higher share of the government's contribution through the use of the thrift plan than younger employees who are generally paid less. For instance, we believe the majority of postal supervisors could not afford to participate to any great extent in the thrift plan. The average salary for a supervisor is now about \$30,000. In our opinion, it is difficult in today's society to have any additional income in which to invest at that salary level particularly if the supervisor is married and has a family.

We believe the overall purpose of the thrift plan should be to provide the "icing on the cake." Employees should not have to depend on the thrift plan for a decent retirement income. The thrift plan should be used to encourage employees to save and thereby provide extras during retirement not as a primary source

of retirement income. Our recommendation is for government to match 50% employee contributions to the thrift plan up to 6%. This would benefit higher paid employees who could participate at a greater rate and still encourage employees at all levels of government to save. The tax deferred component would encourage people to save at either the 100% match or our preferred 50% match. This assumes the President's proposal to eliminate the tax deferred status of so-called 401k plans is not adopted in any tax reform measure. Removing the tax incentive from the thrift plan would make it considerably less attractive.

There are several changes we would like to recommend that would, in our opinion, improve S. 1527 for the government as an employer and for the employee. First, we strongly recommend an elimination of the 2% per year penalty for optional retirement before age 62. The prevailing wisdom behind the adoption of the present unreduced benefit at age 55 with 30 years service still applies. It was adopted, in part, to keep the workforce young and vigorous and to increase the opportunity for younger workers to move up the promotional ladder. It improves employee morale and productivity and has served both employees and the employer well. We support this policy.

It was reported as recently as September 4, 1985 in The Washington Post that CBS, Inc. is encouraging 2,000 of its employees who are at least age 55 and have 10 or more years of service to retire by November 29 of this year. To make early retirement more attractive, the benefits of employees who accept the offer will be computed as if they were five years older and had completed an additional five years of service.

During the Senate policy forum of February 16, 1984, A. Dale Stratton of the E.I. du Pont de Nemours and Company noted, "Despite the legislative trend which increases or eliminates a mandatory retirement age, employee choice continues moving in the other direction. Responding to employee requests, an unreduced

benefit is now available at age 58 after 27 years of service." What du Pont has found over the last 10 years is that the "majority of employees retire between the ages of 58 and 62." The average age of employees retiring under the present Civil Service Retirement system is about age 61. It is with companies such as du Pont that the federal government must compete. According to a recent article by Peter W. Stonebraker in Compensation Review, "Compensation, and more particularly, benefits -- are more dynamic, visible and competitive than ever before." The federal government cannot afford to ignore this trend. Providing for an unreduced annuity at age 55 with 30 years service would cost in terms of percentage of payroll only 0.5% which is relatively small in relation to the benefits we believe it supplies.

Second, we believe there should be full cost-of-living protection. As presently drafted, S. 1527 would provide annual COLAs equal to the change in the CPI minus two percent. Assuming inflation was at 4% a year, under this provision, the retiree would lose 15% of his or her purchasing power over seven years. In 21 years over half would be lost. The primary purpose of a retirement plan is to maintain a retired employee and his or her dependents in a standard of living that is reasonably consistent with the income they enjoyed during pre-retirement years. While a thrift plan may help, it does not alleviate the need for full COLA protection. As noted by Dale B. Grant of the Martin E. Segal Company in the July 10, 1984 policy forum, "If inflation is high during the contribution period, the contributions made on early career salaries will have relatively little value in relation to final earnings. Second, if inflation is high during retirement, the annuity will be inadequate."

Again, I return to the competition the federal government faces. In a study conducted by Hewitt Associates of 577 small-to-large firms, 76% of the companies which granted a pension increase last year or which were considering granting one this year cited the cumulative effect of inflation as one reason and

an effort to maintain a competitive position as another. We recognize providing full COLAs is costly and would add 3% of payroll to the cost of S. 1527, but we believe it is necessary to protect retirees on fixed incomes from the damaging effects of inflation.

Three, we recommend there be an improvement in the accrual rate contained in S. 1527. For a number of years, the present Civil Service Retirement system has assured adequate retirement income after a full career of 30 to 35 years. S. 1527 would not do that for new employees using the 1% accrual rate for each year of service. Social Security benefits plus the defined benefit supplement would be lower than current Civil Service annuities at all but the very lowest pay levels. In an example given by James A. Curtis of the actuarial consulting firm of Milliman & Robertson during the May 30, 1984 policy forum, the accrual rate for a "typical defined benefit plan" was 1.5% of final average salary per year of service. If, for cost reasons, a 1.5% accrual rate is too high, the Congressional Research Service estimates the accrual rate of S. 1527 could be increased to 1.2% for a cost of 2.3% of pay. To encourage career or long term employment, a slightly more costly alternative would be 1% for the first 10 years of service and 1.5% for years after 10.

Four, we recommend a retention of the high-three average salary to determine annuities. Robert D. Krinsky, President of the Martin E. Segal Company during the policy forum on December 13, 1983 gave an excellent reason why final average salary benefit formulas are advantageous. "While other methods have been used to adjust the benefit structure of retirement plans to recognize economic changes up to the point of retirement, basing benefits on final average salary appears to be the most systematic and equitable method of automatically protecting the real value of benefits in relation to rising salaries. Under this type of benefit formula the basic purpose of the retirement system -- to replace some portion of earnings, depending on

length of service, in the event of old age, disability and death -- is directly related to existing economic conditions."

Obviously, basing annuities on a high-three average salary as opposed to a high-five average more closely reflects economic conditions at the time of retirement. A high-five average would reduce annuities by about 7%, yet retaining the high-three average would only increase the cost of the supplemental plan by about .9% of pay. Again, this is a relatively minor cost considering the financial hardship the high-five average would cause postal and federal employees.

Five, we strongly recommend the survivor benefit provisions of S. 1527 be improved. The inadequacy of this provision would leave many survivors nearly destitute as clearly shown in Exhibit 1. Assume a male employee dies at age 45 with 10 years of service and has a constant salary (average salary and final pay) of \$30,000 a year. He is survived by a widow and no children. Under the present Civil Service Retirement System, the widow would receive a survivor annuity of \$550.00 per month beginning immediately (22% of the high-three). Under S. 1527, her defined benefit would be \$73 a month and would not begin until ten years after the death of her spouse when the employee would have been eligible to retire. This is 50% of the earned benefit reduced by 35% for age and another 10% to provide the survivor benefit.

We recognize under S. 1527 the widow would receive a benefit from the thrift plan if the employee participated which could begin immediately or later at her election, and that she would qualify for a Social Security survivor benefit when she reached age 60. However, under the present system, in addition to the survivor annuity of \$550 a month, that same survivor would have income from any savings the employee had laid aside. Also, since the employee did not enter government service until he was 35, in all probability he had at least 40 quarters of Social Security coverage in private employment needed to give his widow a Social Security survivor benefit beginning at age 60.

Last, the survivor would receive under S. 1527 a life insurance payment of \$32,000 (one year's salary plus \$2,000), but this is no different than what she would receive under the present system unless the employee was one of the few who elected to waive life insurance. Obviously, we have given a worst-case example. But, it does clearly show that the survivor benefit provisions of S. 1527 are far below those of the present Civil Service Retirement system. We urge that S. 1527 be revised to give a surviving spouse an immediate benefit equal to 50% of the unreduced earned annuity.

We also recommend an elimination of the increase in the government's contribution to FEGLI, the Federal Employees Government Life Insurance program. The costs for employees is relatively minor and easily affordable and the government's contribution could be better used to improve defined benefits.

Finally, we recommend employees contribute 1.3% to the defined benefit supplement. This would make contributions of old and new employees nearly equal and would reduce government's cost by 1.1% of pay (the 1.1% amount is less due to refunds given to employees who leave before retirement age). We recognize it would be impractical for employees in both the old and new systems to contribute exactly the same amount due to the nature of Social Security contributions. But, we do believe the contributions, like benefits, should be as nearly equal as possible.

With all the changes we have suggested, the 20.8% government cost of S. 1527 would be increased to 24.9% of pay. In Exhibit 2, we detail those changes and the cost associated with each of them. The estimated costs for all the various items were supplied to this Committee by the Congressional Research Service of the Library of Congress. The final cost we reached is roughly equal to the cost of the present Civil Service Retirement system and is consistent with our policy of providing comparability and

equity between old and new postal and federal employees. It is still less than the 25.1% payroll cost for the top 10% of large employers in private industry.

Before concluding our testimony, there are several issues that we would like to mention briefly. In a public hearing, it is impossible to discuss every aspect of such a complex piece of legislation, but we would like to draw your attention to several items. First, in regard to the question of election into the new system by pre-1984 employees, we recommend this decision be deferred for two to five years until the new plan is fully operational. It is almost impossible to provide the employee with all the information needed to make an intelligent election. In any event, the election process would be much simpler after the new system has been operational for some period of time. In testimony before the House Post Office and Civil Service Committee an Administrator of the Maryland State retirement system, which did provide a voluntary election, noted most employees regardless of whether they stayed in the old system or elected into the new, later thought they had made the wrong decision. Consequently, to minimize any confusion and controversy, we recommend this waiting period.

Second, we do not believe it would be wise for the thrift plan monies to be invested in the private sector. Taking money out of government and investing it in the private sector would add to the public debt. Also if private investments do poorly, the loss is borne entirely by the employee. This is unnecessary given the present 11% earnings rate of the Civil Service Retirement fund.

Third, we are somewhat concerned about the requirement for payments to amortize any supplemental liability that may be created. It is our hope this will be clarified in such way that postal rates will not be affected.

Four, in the case of a pre-1984 employee who separates from federal service but is later re-employed, we recommend that he or she remain in the old system.

Five, we think it is wrong to include salaries above the pay cap in the average salary because it bases an annuity on income the employee never had. Retirement programs are for income replacement. They should not be designed or used to correct other inequities.

Six, we urge the Committee to examine the administrative costs of S. 1527. The administrative costs of the present system are about 0.1% of pay, but given the complexities of coordination with not only Social Security, but outside entities as well (disability and thrift plan), the administrative costs of S. 1527 would be much higher than 0.1%.

Seven, the comparisons of replacement rates for the old Civil Service Retirement system and for S. 1527 ignore the fact that old Civil Service Retirement employee income would be much higher if the employee had saved and invested at least 5% of pay.

And, last, unvested amounts of government contributions to the thrift plan should not revert to miscellaneous receipts of the Treasury, but go back to the fund.

There are a number of technical problems we see in S. 1527 but they are relatively minor and we would be happy to get together with your staff to discuss them at a later date. Mr. Chairman, we appreciate the opportunity to offer our views on S. 1527 and want to reiterate our strong commitment to seeing a bill passed this year that is not only in the best interests of the people we represent, but the government as an employer and the American taxpayer. We would be happy to answer any questions.

EXHIBIT I

SURVIVOR BENEFITS UNDER S. 1527

Male employee, dies at age 45

10 Years Service

\$30,000 Constant Pay

| | |
|-------------------|--|
| \$ 3,000.00 | 10% of \$30,000, 1% accrual rate |
| - <u>1,050.00</u> | 35% reduction - 5% per year reduction (10 years service) |
| \$ 1,950.00 | retirement before 62 |
| - <u>195.00</u> | 10% reduction to provide survivor benefit |
| \$ 1,755.00 | |
| - <u>877.50</u> | 50% reduction - survivor benefit is half |
| \$ 877.50 | Divide by 12 months, benefit equals \$73.00 per month |

EXHIBIT II**RECOMMENDED CHANGES TO S. 1527**

| | <u>Government Cost</u> |
|---------------------------------------|------------------------|
| S. 1527 as introduced | 20.8% |
| Age 55-30 retirement unreduced | + .5% |
| Full COLAs | + 3.0% |
| Accrual rate at 1.2% | + 2.3% |
| High-Three Average | + .9% |
| Improvements to Survivor Benefits | + <u>.3%</u> |
| Subtotal | 27.8% |
| Change thrift plan match to 50% of 6% | - 1.6% |
| Eliminate FEGLI increase | - .2% |
| Employees contribute 1.3% | - <u>1.1%</u> |
| Revised government cost of S. 1527 | 24.9% |